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TORONTO...A study prepared for the Ontario Economic Council offers a new perspective on the growth of government intervention in the Canadian economy.

In his study, *Industrial Policy: The Fixities Hypothesis*, author Christopher Green, a McGill University economics professor, suggests that the growth in non-portable and/or non-transferable wealth may be an underlying factor in the growth of interventionist government policies.

Green suggests that the very growth in economic affluence, reflected in the growth of personal or private wealth, may make *some* people less able and less willing to adjust to economic change. He says that if an individual expects to be affected adversely by economic change he will be especially motivated to protect himself by political action if his assets are heavily endowed with the fixity characteristics of non-transferability and/or non-portability. Governments may be persuaded, against their better judgment, to ease pending hardship by moderating or even preventing economic change or the effects of economic change. Examples include tariffs and quotas; subsidies, such as DREE grants; bailouts; turning failing privately-owned firms into publicly owned ones; and various forms of protective regulations.

The problem with these policies is that if the government tries to protect everyone from failing, this widespread intervention in the marketplace produces undesirable economic effects, and poses political dangers as well.

'While I think it quite possible that our very affluence has contributed to the growth of interventionist industrial policies, I am also inclined to believe that widespread intervention is likely to kill the goose that lays the golden egg.'

Assets which may have the fixity characteristics of non-portability and non-transferability include:

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- A home in a town where the only firm or plant closes
- Some employee pension plans
- Seniority and tenure
- A spouse's job
- Local reputation and local environment
- Individual skills, while portable, are non-transferable (cannot be exchanged)

If a person whose assets are heavily endowed with the characteristics of non-portability and non-transferability were to move, it would represent an an important loss of personal wealth.

Green says people faced with such a loss may engage in activities to protect that wealth, such as seeking protection or aid through the political process.

He says that because of the threat of wealth loss, some people may not be willing to move to a job elsewhere, and therefore be less willing to adjust to economic change. This, he says, creates a serious problem for policymakers.

Much of the study deals with three questions or sub-hypotheses:

1. Is there really a growth in personal wealth with fixities characteristics?

2. Has the existence of fixities actually affected individual mobility?

3. Has government action actually been influenced by the existence of fixities?

Household wealth: its growth and composition

The study finds that household wealth has increased substantially and at all nominal income levels over the past few decades. This wealth takes many forms. It is particularly reflected in widespread home ownership and participation in pension plans, in increased investments in individual skills and training, in the quasi-property rights to jobs conveyed by explicit seniority provisions and tenure, and in the increased value placed on local amenities and environment by an increasingly leisure-consuming and health-conscious public.

Homes make up about 60 per cent of Canadian households' non-human wealth. More than half of all Canadian families are homeowners.

'Not surprisingly, home-ownership is highest among the upper income groups, but it is substantial even among Canadians with very low current incomes. Only in the last decade have fewer than 40 per cent of Canadian families with incomes of less than $5000.00 been homeowners. For those low-income families who are homeowners, the home represents a very substantial amount of wealth. In fact, for most low- and middle-income households, to be without equity in a home is to be largely without wealth. The net worth of homeowners is many times higher than that of non-homeowners who have the same income.'

The statistics on household wealth suggest:

- Canadian families at all income levels have more to lose (or gain) from unexpected change in asset values than they did two decades ago.
- Public policies that focus solely or primarily on current income levels may be seriously out of tune with the concerns of households as wealth holders. In fact, the income statistics are seriously misleading in that they fail to capture the imputed income from the major source of household wealth: the home
- By the same token, the wealth statistics mislead to the extent that changes in the market value of housing caused by changing local conditions primarily affect paper wealth and do not reflect changes in the real flow of imputed housing services that the homeowner receives.

Location of owned homes

The study argues that home ownership has played an important role in increasing the levels of household wealth in the past two decades. In and of itself, however, home ownership is not a particularly significant factor in determining geographic mobility - if the dwelling is easily saleale (that is, if a sale will not entail a large capital loss). But if the local real estate market is thin or weak; the fixity problem arises. Is this situation likely? An examination of data contained in Green's study on the location of home ownership is suggestive.

'Home ownership is greatest in the Atlantic region - the part of Canada that has suffered economic decline longest and most severely. Moreover, the percentage of homeowners with no mortgage debt is highest there. This fact is significant not only because it suggests that home equity is a relatively large proportion of wealth and hence

relatively important for residents of the Atlantic region, but also because it implies that most homeowners there must bear the full brunt of a loss of market value (at least an unexpected loss), rather than sharing it with mortgage holders.'

Professor Green says the smaller the population centre, the more the market value of housing is likely to depend on the economic health of a single industry, firm, or plant. And the data show that both home ownership overall and ownership without a mortgage are highest in the smaller communities - the ones most vulnerable to industrial decline. He points out that not all small communities are dependent on a single industry, but many are. This study presents data on single-sector communities, defined as those in which one resource or activity absorbs at least 30 per cent of local employment.

It shows there are a large number of single-sector communities in Canada, a fact highly relevant to the fixities hypothesis and so potentially a factor in the demand for industrial policies. It is also worth noting that, in 1976, of the thirty-three single-sector communities whose principal economic activity was manufacturing, twenty-five were in Quebec and thirteen of these were in the heavily protected textile, clothing, or shoe industries.

Private pension plans

Green's study shows that another common household asset whose importance has increased dramatically in recent decades is the private pension plan.

The growth in the private pension system in Canada since 1960 indicates that the absolute number of persons covered increased by almost 250 per cent in two decades, and the proportion of the labour force covered rose markedly.

'The increase in coverage was even more marked for labour force participants twenty-five years of age and more, an important consideration for the fixities hypothesis since young workers are less likely than their elders to care about pension plan coverage.'

Seniority and tenure

The study finds that considerations related to seniority and tenure may also qualify as fixities, but their growth is difficult to quantify.

'Suffice it to say that the growth of union membership in the 1960s and 1970s undoubtedly increased the number of workers covered by

explicit seniority provisions, although many may already have been covered by implicit contractual arrangements. The increase in the percentage of professional workers, particularly their growing numbers in the public and quasi-public sectors, suggests that the number of workers covered by contractual tenure arrangements has also grown substantially during the past two decades.'

Examples of the effects of fixities

This study concludes that the existence of household fixities may influence individual behaviour.

One way to illustrate the role of potential fixities in household and government production functions is to examine the development of northern mining communities that companies have built up since the Second World War. In many older settlements that were or have become single-sector mining or manufacturing communities, the dominant employer took little or no responsibility for the development and upkeep of housing, the infrastructure, and other community facilities.

In contrast, *the large companies that today undertake the development of communities in areas far from any major established settlement have had to take on the responsibility of building and maintaining facilities to serve and house the community. Moreover, if the industry declines or the ore runs out, the employer is under a good deal of pressure to compensate owners of homes and businesses, who face heavy capital losses. In effect, what would otherwise be fixities in household and government production functions are shifted partially or totally to the firm.*

In his study, Green uses some examples to illustrate the existence of household fixities and the reaction to them during periods of economic change.

Uranium City

This was a town in Sakatchewan built by Eldorado Nuclear Ltd. for its workers in the north.

'In 1982, Eldorado announced that it would close its Uranium City mine, which means the death of a community of 3000 persons after thirty prosperous years. Although the company's decision apparently came as a shock to most of the town's residents, adjustment for most of them has been made much less difficult because jobs in other mining towns are relatively plentiful for experienced miners.

Moreover, Eldorado Nuclear will bear most of the costs associated with property-value loss. Approximately half of the families in Uranium City owned their homes, many of them bought from Eldorado, which is now presumably expected to write off any outstanding mortgage debt and loans for household furnishings. Moreover, a consultant's report stated that the 170 owners of non-company homes and the owners of businesses should receive 'indemnification' up to a maximum of $58,000 for houses and $150,000 for businesses.'

Schefferville and Labrador City

'In November 1982, the Iron Ore Company (IOC) of Canada announced that it was permanently closing its aging iron-ore mines at Schefferville, Quebec, and Labrador City, Newfoundland. The closures effectively mean the death of two towns, which were originally built by the company. In 1981, 25 per cent of Schefferville's 2000 people had lived there twenty years or more, while 30 per cent of Labrador City's 11,500 residents had lived there for ten to twenty years. About 30 per cent of the households in Schefferville and 70 per cent of those in Labrador City owned their homes. IOC had built most of both towns' housing stock for sale or rental. To stabilize the work force, it had encouraged home ownership by providing long-term (often thirty-year) mortgages that included a buy-back provision from first owners within the first five to ten years of the dwelling's lifespan. Moreover, the mortgage rate in many cases was substantially below market rates. Since most migrants to Schefferville and Labrador City did not expect to remain there longer than ten years, homeowners bore little or no risk of capital loss if the mines closed unexpectedly. In the event, the company provided even more protection than it had guaranteed. During the two years before announcing closure, as dwindling demand resulted in a decline of the work force and emigration from Schefferville and Labrador City, IOC provided financial assistance to some families no longer covered by the buy-back provision who were attempting to sell their homes in a deeply depressed market. It is not clear whether IOC will extend similar arrangements to the remaining long-term homeowners now that it has officially announced the closure.'

Canada's Unemployment Insurance System

An interesting example of a fixity created by a government program is supplied by Canada's Unemployment Insurance system (UI).

'Under the UI plan that came into force in 1971, the maximum payout period for benefits varies directly with the regional or provincial unemployment rate as well as the national rate and the beneficiary's weeks of insured employment. The differentials are particularly marked for claimants who have only the minimum number of weeks of

insured employment. For example, in the Maritimes, a region that usually has well-above-average unemployment rates, the maximum payout period for such workers ranges from forty to fifty weeks, about double the maximum in regions with below-average rates. This variation creates a fixity since eligibility to receive UI benefits is a non-transferable asset, and the maxium length of the payout period is not portable across regional boundaries. To the extent that this fixity influences household behaviour, one would predict that it would retard migration from regions with high unemployment (and a relatively long maximum payout period) to regions with low unemployment (and a relatively short maximum payout period). The impact should be greatest on low-income households since they are more likely to experience unemployment and UI benefits constitute a larger fraction of their earnings.'

This is just what Green's fixities hypothesis predicts. A prospective migrant from the Maritimes to Ontario or the West foresees a 'capital loss' equal to the value of the forgone UI benefits times the likelihood that he or she will incur a spell of unemployment longer than the maximum number of weeks he or she would be eligible to receive UI benefits in the province of destination. For a person who is likely to be unemployed, such a loss would represent a substantial cost that must be weighted against the benefits from moving.

The link between the influence of fixities on household behaviour, and government policies

Professor Green says an examination of recent decisions on shoe and clothing import quotas provides some support for the hypothesis that household fixities influenced industrial policy.

But he also hastens to add that evidence that industrial policies are actually influenced by the existence of household and local government fixities is difficult to come by.

Many protected industries hire labourers whose wealth is, in part, probably characterized by fixities, but it is not clear how important an influence on government policy this fact has been.

'Perhaps the most that can be said is that the existence of fixities may make a reversal of policy more difficult. That is, fixities may better explain the continuance of policies rather than their existence in the first place.'

The fixities phenomenon and the government actions it seems to have provoked are an example of a more general phenomenon.

'Whether the historical connection between industrial growth and the growth of democracy in the West is a coincidence or not, the two have produced an interesting tension. The industrial revolution and the economic growth that accompanied it required that resources move, in increasing amounts and with ever-greater speed, to new, more productive uses. Simultaneously, the rise of democratic institutions increased the possbility of the use of voice, providing an increase in non-market means of slowing down economic adjustments that may be socially efficient but are costly to some individuals. Thus, in an industrial democracy, the gap widens between what the economist can show to be efficient overall and the predictable behaviour of individual agents.'

Closing word

Realistically, this study only begins to develop a broader framework within which to understand why government so frequently intervenes in the economy and a source of the pressure to intervene. If the main hypothesis is sufficiently interesting to spur other economists to make further attempts to test it, the study will have accomplished one of its primary purposes.

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Industrial Policy: ***The Fixities Hypothesis***, 79 pages, price $4.00, is available at the following outlets:

The Ontario Government Bookstore, 880 Bay Street, Toronto, to those shopping in person. Out-of-town customers may write: Publications Section, Fifth Floor, 880 Bay Street, Toronto, Ontario, M7A 1N8, or telephone 965-6015 (toll-free long distance, 1-800-268-7540; in northwestern Ontario, 0-Zenith 67200). A cheque or money order, payable to the Treasurer of Ontario, must accompany all mail orders.

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